UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

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CASE NOs.: CV 12-00618 SJO (AGRx) CV 12-02220 SJO **DATE:** January 31, 2013

TITLE: Hilda L. Solis v. Tomco Auto Products Inc., et al.

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PRESENT: THE HONORABLE S. JAMES OTERO, UNITED STATES DISTRICT JUDGE

Victor Paul Cruz Courtroom Clerk	Not Present Court Reporter
COUNSEL PRESENT FOR PLAINTIFF:	**COUNSEL PRESENT FOR DEFENDANTS:**
Not Present	Not Present

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PROCEEDINGS (in chambers): ORDER GRANTING SECRETARY'S MOTION FOR SUMMARY JUDGMENT [Docket No. 159]**; GRANTING SECRETARY'S MOTION FOR ENTRY OF DEFAULT JUDGMENT AGAINST DEFENDANT TOMCO AUTO PRODUCTS, INC.** [Docket No. 167]

This matter is before the Court on Plaintiff United States Secretary of Labor Hilda L. Solis's (the "Secretary") Motion for Summary Judgment ("Motion") against Defendants Richard Alan Schoenfeld ("Schoenfeld") and Tomco Auto Products, Inc. ("Tomco") (collectively, "Defendants"), filed on October 26, 2012, as well as the Secretary's Motion for Entry of Default Judgment Against Defendant Tomco ("Default Motion"), filed on December 21, 2012. Schoenfeld filed an Opposition to the Motion on November 5, 2012, to which the Secretary filed her Reply on November 9, 2012. On December 27, 2012, Schoenfeld filed a Notice of Non-Opposition in response to the Default Motion. Tomco has not filed an opposition or otherwise appeared in this action. The Court found this matter suitable for disposition without oral argument and vacated the hearings set for November 26, 2012, and January 28, 2013. *See* Fed. R. Civ. P. 78(b). For the following reasons, the Court **GRANTS** the Secretary's Motion and Default Motion.

I. FACTUAL AND PROCEDURAL BACKGROUND

The Court finds the following facts to be undisputed.[1] Schoenfeld was a trustee and fiduciary of the Tomco Auto Products, Inc. Employee Stock Ownership Plan (the "Plan"), which was funded

[1] Although Schoenfeld attempts to "dispute" numerous facts asserted by the Secretary, the Court finds that these disputes are, by and large, either not genuine or immaterial to the merits of the Secretary's claims. *See Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986) ("Factual disputes that are irrelevant or unnecessary will not be counted.") Thus, the Court finds that the major, relevant facts in the case are not in dispute, as is admitted by Schoenfeld. (Opp'n 2 ("There is little, if any, dispute regarding the facts in this matter . . . .").)

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by Tomco, a California corporation engaged in the business of rebuilding car and truck parts and a named fiduciary of the Plan. (Def. Schoenfeld's Statement of Genuine Issues of Material Fact ("Def.'s SGI") ¶¶ 1, 2, 18, 19.) In 2003, the owners of Tomco decided to put the assets of the company up for sale, as it was deeply in debt with declining revenues. (Def. Schoenfeld's Responsive Statement of Additional Material Facts and Supporting Evidence ("Def.'s AMF") ¶¶ 5-8.)[2] The owners of Tomco entered negotiations with a potential buyer. (Def.'s AMF ¶ 7.) While negotiations were ongoing in October 2004, Schoenfeld and another trustee of the Plan, Albert Cisneros ("Cisneros"), withdrew $100,000 from the Plan, which funds they used to make out a check for $100,000 payable to Tomco for business expenses, including employee and executive payroll checks. (Def.'s SGI ¶ 4;[3] Decl. of Norman E. Garcia in Supp. of the Secretary's Mot. for Summ. J. ("Garcia Decl.") Ex. S13, at ¶ 7.) Later that month, this $100,000 was repaid to the Plan. (Def.'s AMF ¶ 10.) In November, Schoenfeld and Cisneros authorized wire transfers totaling $97,000 from a Plan account to pay other business expenses of Tomco, including employee and executive payroll checks, payroll taxes, and vendor accounts. (Def.'s AMF ¶¶ 14, 15, 19.) These funds "permitted Tomco to continue operations during the negotiation and sale of assets." (Def.'s SGI ¶ 8;[4] Garcia Decl. Ex. S1, at 7.) Meanwhile, the sale of the Tomco assets to TAP Holdings, LLC ("TAP") was finalized on November 5, 2004, allowing the business to continue under TAP. (Def.'s AMF ¶¶ 16-17.) Schoenfeld continued as an "employee, officer and director of Tomco," was named President of TAP, and was able to continue to draw his salary of $172,900. (Garcia Decl. Ex. S13, at ¶ 11; Garcia Decl. Ex. S6, at 66:15-67:10.)

On February 24, 2005, TAP issued a check for $50,000, payable to the Plan, in partial reimbursement for the $97,000 that was paid out of the Plan in November 2004. (Def.'s AMF ¶ 21.) The remaining $47,000 has not been repaid, and the Secretary alleges that the Plan has also sustained $22,511.36 in lost-opportunity costs (Def.'s SGI ¶ 31.) On February 3, 2011, Schoenfeld filed for bankruptcy under Chapter 13 of the United States Bankruptcy Code. (Secretary's Mot. to Withdraw ("Mot. to Withdraw") ¶ 1, No. CV 12-02220, ECF No. 1.)

On January 17, 2012, the Secretary filed an Adversary Complaint alleging that Schoenfeld's debts to the Plan are non-dischargeable pursuant to 11 U.S.C. § 523(a)(4). (Mot. to Withdraw ¶ 2.) On January 24, 2012, the Secretary filed a Complaint alleging various violations of the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. §§ 1001-1191c by Defendants on the basis of these facts. (*See generally* Compl.) On July 23, 2012, this Court consolidated these

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[2] To the extent the Court relies on evidence to which the Secretary objects, the Secretary's objections are overruled.

[3] Although Schoenfeld "disputes" this fact, the Court finds that there is no genuine dispute, as the Secretary has accurately summarized Schoenfeld's statements.

[4] Again, the Court finds that Schoenfeld's "dispute" of this fact does not rise to the level of a genuine dispute that precludes summary judgment, as the Secretary accurately summarizes Schoenfeld's interrogatory response.

actions. (*See generally* Order Re Consolidation, ECF No. 60.) On September 17, Schoenfeld filed a Motion for Partial Summary Judgment, wherein Schoenfeld argued that he had not committed defalcation under 11 U.S.C. § 523(a)(4), and thus his debt to the Plan was dischargeable. (*See generally* Def.'s Mot. for Partial Summ. J. on Non-Dischargeability Cause of Action Under 11 U.S.C. § 523(a)(4).) The Court denied this motion. (*See generally* Prior Order.) On December 5, 2012, the Secretary applied to the Clerk of the Court for entry of default against Tomco, which the Clerk granted on December 10, 2012.

On October 26, 2012, the Secretary filed the Motion, and on December 21, 2012, the Secretary filed the Default Motion.

II. DISCUSSION

A. The Secretary's Motion for Summary Judgment

1. Legal Standard

Rule 56(a) of the Federal Rules of Civil Procedure mandates that "the court shall grant summary judgment if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a). The moving party bears the initial burden of establishing the absence of a genuine issue of material fact. *See Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986). "When the party moving for summary judgment would bear the burden of proof at trial, it must come forward with evidence which would entitle it to a directed verdict if the evidence went uncontroverted at trial. In such a case, the moving party has the initial burden of establishing the absence of a genuine issue of fact on each issue material to its case." *C.A.R. Transp. Brokerage Co. v. Darden Rests., Inc.*, 213 F.3d 474, 480 (9th Cir. 2000) (citations omitted).

In contrast, when the nonmoving party bears the burden of proving the claim or defense, the moving party does not need to produce any evidence or prove the absence of a genuine issue of material fact. *See Celotex Corp.*, 477 U.S. at 325. Rather, the moving party's initial burden "may be discharged by 'showing'—that is, pointing out to the district court—that there is an absence of evidence to support the nonmoving party's case." *Id.* Once the moving party meets its initial burden, the "party asserting that a fact cannot be or is genuinely disputed must support the assertion." Fed. R. Civ. P. 56(c)(1). "The mere existence of a scintilla of evidence in support of the [nonmoving party]'s position will be insufficient; there must be evidence on which the jury could reasonably find for the [nonmoving party]." *Anderson*, 477 U.S. at 252 (1986); *accord Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586 (1986) ("[O]pponent must do more than simply show that there is some metaphysical doubt as to the material facts."). Further, "[o]nly disputes over facts that might affect the outcome of the suit . . . will properly preclude the entry of summary judgment [and] [f]actual disputes that are irrelevant or unnecessary will not be counted." *Anderson*, 477 U.S. at 248. At the summary judgment stage, a court does not make credibility determinations or weigh conflicting evidence. *See id.* at 249. A court is

required to draw all inferences in a light most favorable to the nonmoving party. *Matsushita*, 475 U.S. at 587.

2. Analysis

The Secretary seeks summary judgment on all claims asserted in her Complaint. Specifically, the Secretary asks the Court to find as a matter of law that Defendants (1) violated the prudent man standard of care under ERISA § 404(a)(1); (2) violated ERISA § 403(c)(1) by causing assets of the plan to inure to the benefit of Tomco and not for the exclusive purpose of providing benefits to the Plan's participants; (3) violated ERISA § 406(a)(1)(B), (D) by engaging in prohibited transactions; (4) violated ERISA § 406(b)(1)-(2) by engaging in self-dealing; and (5) violated ERISA § 405(a) by facilitating and/or failing to prevent breaches of fiduciary duties owed by their co-fiduciaries. In addition, the Secretary argues that the Court should grant summary judgment with respect to the Secretary's claim that Schoenfeld's debt to the plan is non-dischargeable under 11 U.S.C. § 523(a)(4).

The Court notes at the outset that the parties have stipulated that the Plan is covered by the provisions of ERISA within the meaning of 29 U.S.C. § 1002(3) and that Schoenfeld "is and/or was" a fiduciary of the plan pursuant to 29 U.S.C. § 1002(21). (SGI ¶ 17; Garcia Decl. Ex. S16, at ¶¶ 3, 4.) Further, it is not disputed that Tomco was a named fiduciary of the Plan and the Plan Administrator. (SGI ¶ 18; Garcia Decl. Ex. S2, at § 7.1.) Thus, it is unquestioned that the provisions of ERISA apply to the Defendants' conduct with respect to the Plan.

a. Whether Defendants' Actions Violated ERISA § 404(a)(1)

ERISA § 404(a)(1) provides that "a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries . . . ." 29 U.S.C. § 1104(a)(1). Section 404(a)(1) further provides that plan fiduciaries must act for plan participants and beneficiaries' exclusive interest in a prudent manner and in accordance with governing plan documents. 29 U.S.C. § 1104(a)(1)(A), (B), (D). The Secretary contends that Defendants have failed to comply with all of these requirements. (Mot. 6.) The Court finds that Defendants' conduct violated ERISA § (404)(a)(1)(A), (B), and (D).

i. Whether Defendants' Actions Were for the Exclusive Benefit of Plan Participants Pursuant to ERISA § 404(a)(1)(A)

ERISA § 404(a)(1)(A) provides that "a fiduciary shall discharge his duties with respect to a plan . . . for the exclusive purpose of . . . providing benefits to participants and their beneficiaries . . . ." 29 U.S.C. § 1104(a)(1)(A)(i). The Secretary argues that Defendants violated this provision by transferring Plan assets to Tomco to pay operating expenses, as these funds did not **exclusively** benefit the Plan's participants and beneficiaries. Instead, the Secretary contends, this transfer of Plan funds primarily benefitted Defendants themselves. More specifically, the funds allowed Tomco to avoid liquidation and Schoenfeld to continue collecting his salary of $172,900. The

funds also benefitted an unknown number of Tomco employees who were not Plan participants, as they were able to remain employed. (Mot. 6.)

In response, Schoenfeld argues that the Secretary is misconstruing 29 U.S.C. § 1104(a)(1)(A)(i) to require that all Plan participants benefit equally from an ERISA fiduciary's acts. (Opp'n 3.) Schoenfeld concedes that the Plan funds "did not benefit participants in the Plan who were no longer employees of Tomco." (Opp'n 3.) Nevertheless, Schoenfeld argues, "there is no way to quantify the extent of the Plan participants [sic] who did not receive the benefits of payment of their checks and withholding and two years of additional employment even if 'equality' was the standard for benefit." (Opp'n 3.)

In addition to being nonsensical, Schoenfeld's response mischaracterizes the Secretary's argument. Nowhere does the Secretary claim that § 1104(a)(1)(A)(i) requires ERISA fiduciaries to treat all plan participants equally. Rather, the Secretary argues that the transfers of Plan funds were not for the exclusive benefit of Plan participants and beneficiaries, as required by § 1104(a)(1)(A)(i). The Court agrees. Defendants violated the clear statutory language of § 1104(a)(1)(A)(i) by using Plan funds to benefit parties other than Plan participants or beneficiaries—most notably Defendants themselves. This reading of the statute is supported by Ninth Circuit precedent. *See Parker v. Bain*, 68 F.3d 1131, 1140 (9th Cir. 1995) (holding that an ERISA plan fiduciary violated 29 U.S.C. § 1104(a)(1)(A) when he transferred Plan funds to a corporation of which he was a co-owner to pay corporate debts).

Thus, the Court finds that Defendants have breached their fiduciary duty in violation of ERISA § 404(a)(1)(A).

ii. Whether Defendants' Actions Failed to Satisfy the Prudent Man Standard of ERISA § 404(a)(1)(B)

ERISA § 404(a)(1)(B) provides in relevant part that "a fiduciary shall discharge his duties with respect to a plan . . . with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use . . . ." 29 U.S.C. § 1104(a)(1)(B). The Secretary claims that Defendants' transfer of Plan funds violated this provision because (1) Defendants commingled Tomco assets and Plan assets; (2) Defendants did not adequately consider whether there were other alternatives for paying Tomco's business expenses besides using Plan funds; and (3) Defendants transferred Plan funds to Tomco without setting an interest rate or providing for any other compensation to the Plan in exchange for Tomco's use of the Plan funds. (Mot. 7.)

Schoenfeld counters that he "relied on the collection of receivables of Tomco to promptly repay the October 1, 2004 loan which was repaid on October 22, 2004, and on the executed Asset Purchase and Sale Agreement between Tomco and TAP that obligated TAP to repay the loans made on November 1, 2, and 8, 2004." (Opp'n 4.) As noted by the Secretary, this argument does not address the Secretary's contentions that Defendants violated § 1104(a)(1)(B) by commingling

Plan assets and failing to consider alternative sources of funding to pay down Tomco's debts. Thus, even assuming that Schoenfeld acted prudently within the meaning of § 1104(a)(1)(B) by relying on the collection of Tomco receivables and the executed purchase and sale agreement with TAP to repay the Plan, the Court finds that Schoenfeld still failed to act prudently by commingling Tomco and Plan assets and by failing to consider other options for meeting Tomco's obligations. Again, unambiguous Ninth Circuit precedent supports this conclusion. In *Rodrigues v. Herman*, 121 F.3d 1352 (9th Cir. 1997), the court held that an ERISA plan fiduciary violated § 1104(a)(1)(B) by failing to keep plan property separate from company property. *Id.* at 1356. The court reasoned that "[b]y failing to [segregate and earmark plan funds], [the fiduciary] failed to exercise the care and diligence of 'a prudent man acting in a like capacity and familiar with such matters.'" *Id.* Defendants' conduct here is indistinguishable from that in *Rodrigues*, as it is not disputed th t Plan and Tomco assets were commingled; Schoenfeld himself stated that Plan funds were transferred to Tomco accounts. (SGI ¶¶ 20-22; Garcia Decl. Ex. S13, at ¶ 7.) The Court therefore holds that Defendants' commingling of Plan and Tomco assets violated the prudent man standard of § 1104(a)(1)(B).

The Court also finds that Defendants failed to comply with the prudent man standard by failing to consider other alternatives for paying down Tomco's debts. *See Marshall v. Glass/Metal Ass'n & Glaziers & Glassworkers Pension Plan*, 507 F. Supp. 378, 384 (D. Haw. 1980) (finding an ERISA plan trustee violated the prudent man standard by "fail[ing] to follow the procedures that a prudent lender would utilize" by "committing Plan assets without adequate procedures and evaluation of the risks involved and alternatives available . . . ."). Here, Schoenfeld admitted in deposition testimony that "we did not explore . . . anything other than the bank [line of credit to Tomco], and the bank money was not available anymore." (Garcia Decl. Ex. S7, at 497:1-3.) This testimony conclusively establishes that Defendants did not adequately evaluate alternative sources of funding. Thus, the Court finds that this conduct also breached the prudent man standard of § 1104(a)(1)(B).

Accordingly, the Court finds that Defendants breached their fiduciary duty in violation of ERISA § 404(a)(1)(B).

iii. Whether Defendants Violated ERISA § 404(a)(1)(D) by Failing to Abide by Governing Plan Documents by Making Loans to Tomco

ERISA § 404(a)(1)(D) provides that "a fiduciary shall discharge his duties with respect to a plan . . . in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with [ERISA]." 29 U.S.C. § 1104(a)(1)(D). The Secretary contends that Defendants violated this statute by transferring Plan funds to Tomco in contravention of governing Plan documents. Paragraph 4.4 of the Plan provides:

> The Trustee may **borrow** funds for the benefit of the Plan and Trust; provided, any loan must be primarily for the benefit of the Participants

> and their beneficiaries and, notwithstanding any other provision of this Plan or the Trust, all Exempt Loans **to the Trust** must meet the requirements of and be in compliance with Code Section 4975(d)(3), ERISA Section 408(b)(3), and applicable regulations thereunder.

(Garcia Decl. Ex. S2, at § 4.4) (emphasis added).

Schoenfeld contends that this language is poorly drafted and "can be read to permit loans . . . ." (SGI ¶ 25.) The Court does not agree. The plain meaning of Paragraph 4.4 is that a fiduciary may **borrow**, as opposed to loan, Plan funds. This reading of the Plan is supported by the Summary Plan Description, which provides that "the Plan does not permit the Trustee to make loans to Plan Participants." (Garcia Decl. Ex. S10, at ¶ 16.) Furthermore, 26 U.S.C. § 4975(d)(3) and 29 U.S.C. § 1108(b)(3), which are referenced in Paragraph 4.4, both pertain only to loans made to ERISA plans, and not from ERISA plans.[5] In light of this evidence, and given that Schoenfeld provides no support for his contention that the Plan can be read to permit loans, the Court finds that there is no genuine dispute as to the meaning of Paragraph 4.4: it only authorizes fiduciaries such as Defendants to borrow funds for the Plan. *See Fed. Trade Comm'n v. Neovi, Inc.*, 604 F.3d 1150, 1159 (9th Cir. 2010) (holding that "bald, uncorroborated, and conclusory assertions" are insufficient to raise a genuine issue of material fact).

Thus, given that there is no other language in the Plan that could possibly be read to authorize the transfer of Plan funds to Tomco, the Court finds that Defendants failed to abide by the Plan by transferring Plan funds to Tomco, and therefore Defendants violated ERISA § 404(a)(1)(D).

b. Whether Defendants Violated ERISA § 403(c)(1) by Causing Plan Assets to Inure to the Benefit of Tomco and Not to the Exclusive Benefit of Plan Participants

ERISA § 403(c)(1) provides in pertinent part that "the assets of a plan shall never inure to the benefit of any employer and shall be held for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries and defraying reasonable expenses of administering the plan." 29 U.S.C. § 1103(c)(1). The Secretary asserts that Defendants clearly violated this provision by transferring Plan funds to Tomco, an employer. (Mot. 9.) Schoenfeld does not address this argument in his Opposition. (*See generally* Opp'n.)

As established above, it is undisputed that Plan funds were transferred to Tomco to pay business expenses, including employee and executive payroll, payroll taxes, and vendor accounts. (Garcia

[5] I.R.C. § 4975(d)(3) of the provides a tax exemption for "any loan **to** a leveraged employee stock ownership plan . . . ." 26 U.S.C. § 4975(d)(3) (emphasis added). ERISA § 408(b)(3) similarly provides for other statutory exemptions for "[a] loan **to** an employee stock ownership plan . . . ." 29 U.S.C. § 1108(b)(3) (emphasis added).

Decl. Ex. S13, at ¶ 7.) It is also undisputed that not all of Tomco's employees were Plan participants. (SGI ¶ 14.)

The Court therefore finds that Plan funds inured to the benefit of Tomco, an employer, and were not "held for the exclusive purposes of providing benefits to participants in the [Plan] and their beneficiaries" in violation of ERISA § 403(c)(1).

c. Whether Defendants Engaged in Prohibited Transactions in Violation of ERISA § 406(a)(1)(B) and (D)

ERISA § 406(a)(1)(B) provides that "[a] fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect . . . lending of money or other extension of credit between the plan and a party in interest . . . ." 29 U.S.C. § 1106(a)(1)(B). ERISA § 406(a)(1)(D) prohibits transactions that "constitute[] a direct or indirect . . . transfer to, or use by or for the benefit of a party in interest, of any assets in the plan . . . ." 29 U.S.C. § 1106(a)(1)(D). Tomco, as a named fiduciary of the Plan and an "employer any of whose employees are covered by" the Plan, is a party in interest pursuant to 29 U.S.C. § 1004(14)(A), (C). Schoenfeld is also a party in interest, as h is a fiduciary of the plan and he was an "employee, officer, [or] director" of Tomco. 29 U.S.C. § 1002(14)(A), (H).

The Secretary contends that "Defendants violated ERISA §§ 406(a)(1)(B) and (D) because they caused assets of the Plan to be transferred to Tomco to pay expenses other than Tomco's obligations to the Plan, thus creating a debt owed by parties in interest to the Plan." (Mot. 10.) Schoenfeld counters that the Plan fund transfers to Tomco were exempt under 29 U.S.C. § 1108(b)(1) because "[a]lthough the funds were technically loaned to Tomco, they were used by Tomco for the benefit of plan participants who were current employees of Tomco . . . [because] the loans were for the purpose of paying current employee wages and withholding, and potentially benefitted all participants who were currently employed . . . ." (Opp'n 5 (emphasis added).)

Schoenfeld's argument is without merit, as is apparent from a cursory examination of 29 U.S.C. § 1108(b)(1). That section provides in relevant part:

> The prohibitions provided in section 1106 of this title shall not apply to . . . [a]ny loans made by the plan to parties in interest who are participants or beneficiaries of the plan if such loans (A) are available to all such participants and beneficiaries on a reasonably equivalent basis, (B) are not made available to highly compensated employees . . . in an amount greater than the amount made available to other employees, (C) are made in accordance with specific provisions regarding such loans set forth in the plan, (D) bear a reasonable rate of interest, and (E) are adequately secured.

29 U.S.C. § 1108(b)(1). Schoenfeld fails to meet any of the requirements set forth in § 1108(b)(1) to qualify for the exemption. First, given that only some Plan participants were employees of Tomco at the time the Plan funds were transferred to Tomco, Schoenfeld's argument that the loan satisfied § 1108(b)(1)(A) fails because that provision requires that loans be made available to all Plan participants. (Garcia Decl. Ex. S7, at 430:13-23.) Second, Schoenfeld does not even attempt to argue that the other requirements of § 1108(b)(1) were met. Indeed, such an argument would be futile, as (1) nothing in the governing Plan documents allowed for the type of Plan fund transfers at issue here; (2) no interest rate was set; and (3) the transfer was unsecured. (Garcia Decl. Ex. S7, at 0171.)

As such, the Court finds that the transfer of Plan funds to Tomco did not qualify for the § 1108(b)(1) exemption, and thus Defendants engaged in prohibited transactions in violation of ERISA § 406(a)(1)(B) and (D). *See Landwehr v. DuPree*, 72 F.3d 726, 734 (9th Cir. 1995) ("Section 1106 prohibits the lending of plan funds or the transfer of assets to employers, employees, plan accountants, and other parties in interest alike.").

d. Whether Defendants Engaged in Self-Dealing in Violation of ERISA § 406(b)(1) and (2)

ERISA § 406(b)(1) provides that "[a] fiduciary with respect to a plan shall not . . . deal with the assets of the plan in his own interest or for his own account." 29 U.S.C. § 1106(b)(1). Section 1106(b) "thus creates a per se violation; even in the absence of bad faith, or in the presence of a fair and reasonable transaction, § 1106(b) establishes a blanket prohibition of certain acts, easily applied, in order to facilitate Congress' remedial interest in protecting employee benefit plans." *Patelco Credit Union v. Sahni*, 262 F.3d 897, 911 (9th Cir. 2001). The Secretary argues that Tomco engaged in self-dealing "by using assets of the Plan to pay its general operating expenses." (Mot. 10.) As for Schoenfeld, the Secretary contends that he "had an interest in paying Tomco's debts so that Tomco could avoid liquidation, sell its assets to TAP, and allow Schoenfeld to continue receiving a $172,900 annual salary plus perks, as President of TAP." (Mot. 10.) Schoenfeld makes only the conclusory assertion that "[t]he Secretary has not established *any* self-dealing by Mr. Schoenfeld." (Opp'n 3.)

Defendants have clearly engaged in self-dealing in violation of ERISA § 406(b)(1). Tomco used Plan funds to pay down its debts so that it could remain afloat long enough for the asset sale to TAP to come to fruition. This is the essence of self-dealing. *See Raff v. Belstock*, 933 F. Supp. 909, 915-16 (N.D. Cal. 1996) ("Transactions between a plan and a fiduciary are prohibited by 29 U.S.C. section 1106(b). Prohibited transactions include loans from a plan to a fiduciary.") As for Schoenfeld, he also benefitted from the Plan funds transfer because it allowed him to continue as a highly paid officer and director of first Tomco and then TAP, and so he "deal[t] with assets of the plan in his own interest." 29 U.S.C. § 1106(b)(1); *see Pension Benefit Guar. Corp. v. Solmsen*, 671 F. Supp. 938, 945-46 (E.D.N.Y. 1987) (finding a corporation's president to be in violation of § 1106(b)(1) when he used plan funds for corporate expenses).

The Secretary also claims that Defendants violated ERISA § 406(b)(2), which provides that "[a] fiduciary with respect to a plan shall not . . . in his individual or any other capacity act in any transaction involving the plan on behalf of a party . . . whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries . . . ." 29 U.S.C. § 1106(b)(2). In *Donovan v. Mazzola*, 716 F.2d 1226 (9th Cir. 1983), the Ninth Circuit held that "[f]iduciaries acting on both sides of a loan transaction cannot negotiate the *best* terms for either [party]. . . . Each [party] must be represented by trustees who are free to exert the maximum economic power manifested by their fund whenever they are negotiating a commercial transaction." *Id.* at 1238. Because the defendants in *Donovan* acted on both sides of a transaction between two ERISA plans, the court upheld the district court's determination that they had violated § 1106(b)(2). *Id.* at 1238. Here, Defendants violated § 1106(b)(2) by acting on both sides of the transfer of funds from the Plan to Tomco. That is, Defendants acted both as the lender and as the borrower. Thus, Defendants could not exert maximum economic power for the Plan or its participants. This is demonstrated by the fact that the transfer of funds was unsecured and no interest rate was set.[6]

Thus, the Court finds that Defendants also violated ERISA § 406(b)(2).

e. Whether Defendants Facilitated and/or Failed to Prevent Breaches of Fiduciary Duties Owed by Co-Fiduciaries in Violation of ERISA § 405(a)

ERISA § 405(a) provides that plan fiduciaries are liable for the acts of co-fiduciaries when a fiduciary "participates knowingly in . . . an act . . . of such other fiduciary, knowing such . . . act . . . is a breach" or when he enables a co-fiduciary to commit a breach of fiduciary duty by failing to comply with ERISA § 404(a)(1). 29 U.S.C. § 1105(a). The Ninth Circuit has held that § 1105(a) "effectively imposes on every ERISA fiduciary an affirmative duty to prevent other fiduciaries from breaching their duties for which they are jointly and severally liable." *Stewart v. Thorpe Holding Co. Profit Sharing Plan*, 207 F.3d 1143, 1157 (9th Cir. 2000).

Given the violations of ERISA already detailed above, the Court finds that Defendants also violated ERISA § 405(a) because Schoenfeld and Tomco each enabled the other to commit the aforementioned breaches of fiduciary duty.

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[6] While Schoenfeld concedes that no interest rate was set, he does note that an unrelated October 2005 settlement agreement between Tomco and TAP provided for TAP to pay any accrued interest on the Plan fund transfers. (Def.'s SGI ¶ 24; Def.'s Ex. 22, at ¶ 6.) Leaving aside the fact that Schoenfeld does not authenticate the settlement agreement, that TAP agreed to pay interest on the fund transfers in 2005 does not exonerate Schoenfeld for his failure to set an interest rate at the time he authorized the transfers in 2004.

f. Whether Schoenfeld's Debt to the Plan is Non-Dischargeable Pursuant to 11 U.S.C. § 523(a)(4)

The relevant portion of 11 U.S.C. § 523(a)(4) provides that "[a] discharge . . . does not discharge an individual debtor from any debt . . . for fraud or defalcation while acting in a fiduciary capacity . . . ." 28 U.S.C. § 523(a)(4). A debt is non-dischargeable under § 523(a)(4) when (1) an express trust existed; (2) the debt in question was caused by fraud or defalcation; and (3) the debtor was a fiduciary to the creditor at the time the debt was created. *In re Niles*, 106 F.3d 1456, 1459 (9th Cir. 1997). Defalcation is the "misappropriation of trust funds or money held in any fiduciary capacity [or] the failure to properly account for such funds." *In re Lewis*, 97 F.3d 1182, 1186 (9th Cir. 1996) (internal quotation marks omitted). Defalcation "includes innocent, as well as intentional or negligent defaults so as to reach the conduct of all fiduciaries who were short in their accounts." *Id.*

The Secretary argues that Schoenfeld's conduct fulfills all three elements. (Mot. 14-15.) First, it is undisputed that the Tomco Auto Products, Inc. Employee Stock Ownership Trust was in existence at the time Schoenfeld authorized the transfer of Plan funds to Tomco (Def.'s SGI ¶ 28), and that Schoenfeld was a fiduciary of the Plan (Def.'s SGI ¶ 19). The Secretary contends that Schoenfeld committed defalcation because he "misappropriated trust funds and failed to account for them when he used Plan assets to pay the business expenses of Tomco." (Mot. 14-15.) In opposition, Schoenfeld claims that "the facts do not support any claim of self-dealing or failure to account," and thus "the nondischargeability claim must fail." (Opp'n 7.) Schoenfeld again fails to support this conclusory assertion with any evidence whatsoever.[7]

In this case, Schoenfeld utilized Plan assets to pay Tomco's business expenses in violation of ERISA, and he has since failed to repay the debt. (Garcia Decl. Ex. S7, at 502:6-503:1.) This conduct constitutes a "misappropriation of trust funds" within the ambit of § 523(a)(4). *Lewis*, 97 F.3d at 1186; *see also Hemmeter*, 242 F.3d at 1191 ("[T]he essence of defalcation in the context of § 523(a)(4) is a failure to produce funds entrusted to a fiduciary.").

Accordingly, the Court finds that Schoenfeld has committed defalcation within the meaning of § 523(a)(4), and thus his debt to the Plan is non-dischargeable.

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[7] Schoenfeld seems to argue, once again, that the Ninth Circuit's holding in *In re Hemmeter*, 242 F.3d 1186 (9th Cir. 2001), precludes a finding that breaches of fiduciary duty in violation of ERISA constitute defalcation. The Court has already heard and rejected this argument in its Prior Order. The Court therefore incorporates its prior finding that "the court in *Hemmeter* held that a fiduciary under ERISA may also be a fiduciary for the purposes of § 523(a)(4), but that the specific fiduciary breaches **in that case** did not constitute defalcation." (Prior Order 4.)

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES - GENERAL

CASE NOs.: CV 12-00618 SJO (AGRx) **DATE:** January 31, 2013
CV 12-02220 SJO

B. The Secretary's Motion for Default Judgment

1. Legal Standard

To obtain default judgment, the Secretary must satisfy the procedural requirements of Federal Rule of Civil Procedure ("Rule") 55 and show that the substantive factors outlined in *Eitel v. McCool*, 782 F.2d 1470, 1471-72 (9th Cir. 1986), favor default judgment. The Court addresses these requirements in turn.

2. Procedural Requirements for Default Judgment

Obtaining default judgment is a two-step process. First, the clerk of the court enters defendant's default if the plaintiff establishes default by affidavit or otherwise. Fed. R. Civ. P. 55(a). Second, the plaintiff must apply to the court for a default judgment if the plaintiff's claim is for a sum that is not certain, or a sum that cannot be made by computation. Fed. R. Civ. P. 55(b).

Pursuant to Local Rules in the Central District of California, applications for default judgment must be accompanied by a declaration that includes the following information:

(1) When and against what party the default was entered;
(2) The identification of the pleading to which default was entered;
(3) Whether the defaulting party is an infant or incompetent person, and if so, whether that person is represented by a permissible representative;
(4) That the Servicemembers Civil Relief Act (50 App. U.S.C. § 521) does not apply; and
(5) That notice has been served on the defaulting party, if the defaulting party has appeared in the action.

L.R. 55-1. To comply with the procedural requirements, the Secretaryhas provided the declaration of Danielle L. Jaberg. (Decl. of Danielle L. Jaberg in Supp. of Mot. for Default J. ("Jaberg Decl."), ECF No. 167-2.) The declaration satisfies the requirements by alleging that (1) default was entered against Tomco on December 10, 2012; (2) default was entered for failure to respond to the Secretary's Complaint; (3) Tomco is not an infant or incompetent person; (4) the Servicemembers Civil Relief Act does not apply; and (5) Tomco has not appeared in the action. (Jaberg Decl. ¶¶ 1-8.) The Secretary has therefore satisfied all of the procedural requirements for default judgment.

3. Substantive Requirements for Default Judgment

A district court's decision to grant or deny default judgment is discretionary. *Aldabe v. Aldabe*, 616 F.2d 1089, 1092 (9th Cir. 1980). In exercising its discretion, a court considers the following factors:

(1) The possibility of prejudice to the plaintiff;
(2) The merits of plaintiff's substantive claim;
(3) The sufficiency of the complaint;
(4) The sum of money at stake in the action;
(5) The possibility of a dispute concerning material facts;
(6) Whether the default was due to excusable neglect; and
(7) The strong policy underlying the Federal Rules of Civil Procedure favoring decisions on the merits.

Eitel, 782 F.2d at 1471-72. Once the court clerk has entered a party's default, "the well-pleaded factual allegations of the complaint are taken as true, except for those allegations relating to damages." *Philip Morris USA, Inc. v. Castworld Prods., Inc.*, 219 F.R.D. 494, 498 (C.D. Cal. 2003) (citing *TeleVideo Sys., Inc. v. Heidenthal*, 826 F.2d 915, 917 (9th Cir. 1987)). The Court considers each of the *Eitel* factors in turn.

a Possibility of Prejudice to Plaintiff

The first *Eitel* factor considers whether the Secretary will suffer prejudice if default judgment is denied. *Eitel*, 782 F.2d at 1471. A plaintiff suffers prejudice when denied the opportunity to resolve its claim in court. *See PepsiCo, Inc. v. Cal. Sec. Cans*, 238 F. Supp. 2d 1172, 1177 (C.D. Cal. 2002). The Court finds that because Tomco acted as the plan administrator, the Secretary will be prejudiced unless default judgment is entered, as otherwise complete relief could not be afforded. Accordingly, the Secretary will likely suffer prejudice absent entry of default judgment, and therefore this factor weighs in favor of default judgment.

b. Merits of the Substantive Claim and Sufficiency of the Complaint

The second factor, in combination with the third, essentially requires that the Secretary state a claim for which relief may be granted. *Danning v. Lavine*, 572 F.2d 1386, 1388 (9th Cir.1978); *Trs. of ILWU-PMA Pension Plan v. Coates*, No. 11–CV–03998, 2012 WL 2572061, at *4 (N.D. Cal. July 2, 2012). After a default has been entered, the well-pleaded factual allegations of the complaint are taken as true, except for those allegations relating to damages. *See TeleVideo*, 826 F.2d at 917-18.

The Complaint sets forth the following allegations, which the Court accepts as true. Tomco established the Plan and was plan administrator. (Compl. ¶ 5, 11-12.) Tomco was and is a fiduciary of the Plan and a party in interest to the Plan within the meaning of ERISA. (Compl. ¶ 5.) Tomco is liable as a fiduciary and co-fiduciary for the ERISA violations detailed above. (Compl. ¶ 21.) More specifically, Tomco's co-fiduciaries caused $197,000 in withdrawals from the Plan's accounts, of which $47,000 have not been restored, along with the lost-opportunity costs suffered as a direct result of the withdrawals. (Compl. ¶¶ 17-19.) These allegations are sufficient to state a claim for violation of ERISA. This factor therefore weighs in favor of granting default judgment against Tomco.

c. Sum of Money at Stake

For the fourth *Eitel* factor, "the court must consider the amount of money at stake in relation to the seriousness of Defendant's conduct." *PepsiCo, Inc. v. Cal. Sec. Cans*, 238 F. Supp. 2d 1172, 1176 (C.D. Cal. 2002). "Default judgment is disfavored when a large amount of money is involved or unreasonable in light of the potential loss caused by the defendant's actions." *Li v. A Perfect Day Franchise, Inc.*, No. 5:10–CV–01189, 2012 WL 2236752, at *11 (N.D. Cal. June 15, 2012). The Secretary seeks damages in the amount of $69,511.36 with interest on the judgment calculated pursuant to 28 U.S.C. § 1961(a). The Secretary arrived at this amount by taking the $47,000 that was withdrawn from the Plan and never returned and adding $22,511.36 in lost-opportunity costs calculated at the Internal Revenue Code underpayment rate set forth in 26 U.S.C. § 6621(a)(2) through February 2, 2011, the date when Schoenfeld filed for bankruptcy. (Decl. of Ty Fukumoto in Supp. of Mot. for Default J. ¶¶ 9-10, ECF No. 167-3.) Because the sum of money at stake is derived from the amount of money improperly withdrawn from the Plan, the Court finds that this factor favors the entry of default judgment against Tomco.

d. Possibility of Dispute Concerning Material Facts

The fifth *Eitel* factor examines the likelihood of dispute between the parties regarding the material facts surrounding the case. *Eitel*, 782 F.2d at 1471-72. When a complaint and motion for default judgment are unopposed, the factor is neutral because the possibility of a dispute is unknown. *Bd. of Trs. of Laborers Health & Welfare Trust Fund v. Perez*, No. C–10–2002, 2011 WL 6151506, at *8 (N.D. Cal. Nov. 7, 2011). There has been no response from Tomco as to the truth of the Secretary's factual allegations against Tomco because Tomco has not entered this action. Further, as set forth above, Schoenfeld, the only active defendant, does not genuinely dispute the material facts in this case. Therefore, this factor also favors entry of default judgment

5. Possibility of Excusable Negligence

The sixth factor considers whether Tomco's default is the result of excusable neglect. *Eitel*, 782 F.2d at 1472. Tomco was served with the Summons and Complaint on March 1, 2012. (Proof of Service, ECF No. 16.) On December 10, 2012 the Clerk of the Court entered default against Tomco. (ECF No. 166.) Tomco has had ample opportunity to respond, and has negligently failed to respond to the Complaint or otherwise appear in this action. The Court sees no reason to excuse such negligence. Accordingly, this factor weighs in favor of granting default judgment.

6. Public Policy Favoring Decisions on the Merits

The final *Eitel* factor encourages the Court to consider the strong federal policy in favor of making decisions on the merits. *Eitel*, 782 F.2d at 1472. Courts have recognized, however, that "this preference, standing alone, is not dispositive." *Cal. Sec. Cans*, 238 F. Supp. 2d at 1177. "Moreover, Defendant's failure to answer Plaintiff['s] Complaint makes a decision on the merits impractical, if not impossible." *Id.* Under Rule 55(a), "termination of a case before hearing the

merits is allowed whenever a defendant fails to defend an action." *Id.* Given that Tomco has failed to file an answer to the Complaint or an opposition to the instant Default Motion, this factor is neutral.

On balance, the Court finds that the application of the *Eitel* factors to this case entitle the Secretary to default judgment against Tomco.

C. Relief Sought

The Court now turns its attention to the relief sought by the Secretary. Rule 54(c) of the Federal Rules of Civil Procedures provides that "[a] default judgment must not differ in kind from, or exceed in amount, what is demanded in the pleadings." Fed. R. Civ. P. 54(c). In the Complaint, the Secretary sought (1) damages in the amount of Plan losses, including lost-opportunity costs, resulting from fiduciary breaches committed by Defendants; (2) an injunction prohibiting Defendants from violating ERISA or serving as fiduciaries for any ERISA plan; (3) an injunction removing Tomco as Plan Administrator and from any position it now holds as fiduciary of the Plan; (4) the appointment of an independent fiduciary to distribute the Plan's assets to the participants and beneficiaries of the Plan, terminate the Plan, and conclude any Plan-related matters; (5) a declaration that Schoenfeld and Tomco are jointly and severally liable of paying all costs associated with the appointment and retention of the independent fiduciary; (6) an injunction requiring Schoenfeld and Tomco to cooperate with the independent fiduciary; and (7) costs. (Compl. Prayer for Relief.)

In the Default Motion, the Secretary seeks a judgment (1) requiring Tomco to restore losses to the Plan resulting from Defendants' violations of ERISA; (2) enjoining Tomco from acting as a fiduciary; (3) enjoining Tomco from further violating ERISA; and (4) appointing an independent fiduciary. (Default Mot. 8-10.) Thus, the relief sought by the Secretary in its Default Motion accords with that sought in the Complaint.

1. Restoration of Plan Losses

As discussed, the Secretary seeks the restoration of $69,511.36 to the Plan as a result of Defendants' breaches of fiduciary duty. ERISA section 409(a) makes all breaching fiduciaries "personally liable to make good" to the Plan all plan losses resulting from their breaches. 29 U.S.C. § 1109(a). The Secretary has introduced undisputed evidence that Defendants caused $47,000 to be withdrawn from Plan accounts that has not yet been repaid. Further, the Secretary has calculated lost-opportunity costs of $22,511.36. The Court finds that it is appropriate to find Defendants joint and severally liable to restore these losses to the Plan. *See Stewart v. Thorpe Holding Co. Profit Sharing Plan*, 207 F.3d 1143, 1157 (9th Cir. 2000).

The Secretary also seeks prejudgment interest as calculated under 26 U.S.C. § 6621 and postjudgment interest under 28 U.S.C. § 1961. A district court may award prejudgment interest in an ERISA case at the court's discretion. *Blankenship v. Liberty Life Assur. Co. of Boston*, 486

F.3d 620, 627-28 (9th Cir. 2007). In this case, although the Court finds that Defendants have breached their fiduciary duties to the Plan, the Court is not persuaded that Defendants acted in bad faith. Thus, the Court declines to award prejudgment interest. However, the Court will award postjudgment interest in accordance with 28 U.S.C. § 1961.

2. Injunctive Relief

ERISA section 409(a) also provides that a fiduciary who breaches her duty to a plan "shall be subject to such other equitable or remedial relief as the court may deem appropriate." 29 U.S.C. § 1109(a). "It is well-settled that ERISA grants the court wide discretion in fashioning equitable relief to protect the rights of pension fund beneficiaries." *Solis v. Hutcheson*, No. 1:12-CV-236-EJL, 2012 WL 2151525, at *6 (D. Idaho June 13, 2012); *Katsaros v. Cody*, 744 F.2d 270, 281 (2d. Cir. 2006). Such relief may include "removal of the fiduciary[,] . . . [a] permanent injunction against serving as a fiduciary[,] . . . and appointing an independent fiduciary . . . to administer the plan . . . ." *Hutcheson*, 2012 WL 2151525, at *6.

Here, in light of the serious misconduct on the part of Defendants in misusing Plan funds, the Court finds appropriate equitable relief to include a permanent injunction against Defendants from serving as fiduciaries and the appointment of an independent fiduciary to manage the Plan going forward.

III. RULING

For the foregoing reasons, the Court **GRANTS** the Secretary's Motion for Summary Judgment. The Court also GRANTS the Secretary's Motion for Default Judgment against Tomco. Judgment is granted in favor of the Secretary.

IT IS SO ORDERED.